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UNCLAS SECTION 01 OF 02 VIENNA 000615

SIPDIS

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SUBJECT: Austrian Economy - Rough First Quarter, More Pain to Come

REF: (A) VIENNA 91; (B) VIENNA 484 and previous

11. SUMMARY: Austria's economy contracted 2.8% in the first quarter of 2009 (versus Q4/2008) on the basis of falling exports and investments; GDP is expected to shrink by at least 3% in 2009 and stagnate in 2010. Economists expect Austria's second quarter downturn to be less steep, but express uncertainty now that the crisis is spreading to SMEs and (via the labor market) to private households. While better than in many Eurozone economies, Austria's bleak labor market prospects are straining the country's consensus-oriented industrial relations. Economists want the GoA to accelerate stimulus spending and welcomed a recent GoA move to guarantee EUR 10 billion in bank loans to Austrian industrial firms.
END SUMMARY.

12. The May 15 economic report of the Vienna-based Institute for Economic Research/WIFO shows the Austrian economy continuing to worsen. In the first quarter, the economy contracted 2.8% (real terms, seasonally and working day adjusted) compared to the previous quarter and 3.6% versus Q1/2008, following a relatively mild Q4/2008 contraction (-0.4%). First quarter GDP was hit by a steep fall in exports and investment (both down 4.4% Q-on-Q). Goods exports (in nominal terms) fell by 25% in the first quarter compared to Q1/2008. Private household consumption was the only stabilizing element.

13. Local economists say March 27 consensus forecasts by WIFO and the Institute for Advanced Studies/IHS (ref B) -- which are the basis for the GoA's draft budget -- are now obsolete. The Austrian economy will shrink by at least 3% this year and stagnate in 2010. NOTE: European Commission, and OECD forecasts for 2009 are more pessimistic at about -4%. END NOTE.

Effects on Labor Market / "Social Partnership"

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14. Economists expect Austria's second quarter downturn to be less drastic because of rebounding automotive sales due to a temporary scrapping premium (ref A) and seasonal factors such as tourism receipts (with Easter falling in April this year) -- but say the downturn is only now starting to hit the labor market. In March, 271,000 Austrians were unemployed (up almost 40% from March 2008) or 4.5% (up from 3.9% in the fourth quarter and 4.0% in January). In addition, some 60,000 workers are now in subsidized "short-time" (furlough) status -- keeping unemployment figures low.

15. Austria's "social partnership" is under strain from the difficult labor market situation. Companies and employer associations, warning of mass layoffs, seek more flexible furlough arrangements and essentially flat wage agreements. This has sparked a furious reaction by trade unions and the labor chamber, who are now organizing street demonstrations in protest. With the labor market expected to deteriorate further, more tensions are likely with the potential for strikes (a rarity in Austria) and spillover into

coalition politics.

Effects on Industry

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¶6. Detailed first-quarter results are not yet available, but preliminary data show double-digit declines in industrial output, with a fall of over 10% expected for all of 2009. Local economists applauded Austria's prompt enactment of fiscal stimulus in late 2008 (including infrastructure projects, investment credits, loan guarantees and SME subsidies) but say implementation has been slow. Six months after spending measures were legislated, their effects are not yet visible. Economists are urging the GoA to speed up implementation and head off trickle-down effects on small and medium-sized enterprises. So far, the crisis primarily hit large industries, in particular automotive suppliers and the paper/carton industry. With dramatic drops in new orders in the first quarter, the low point in output will not be reached before the summer.

¶7. To help Austrian industry overcome its cash flow and financing problems, FinMin Josef Proell (OVP/conservative People's Party) announced that the GoA will use EUR 10 billion (of EUR 75 billion set aside for interbank loan guarantees) to guarantee bank loans to industrial enterprises. To be eligible, companies must be solvent, with at least 250 employees and annual sales of more than EUR 50 million. The GoA is seeking parliamentary approval before the summer recess in mid-July. NOTE: Guarantees would cover only industrial loans, not bond issues.

COMMENT

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¶8. The severe recession is straining Austria's social partnership, its framework of consensus-based negotiation among labor, business, agriculture, and government which hammers out economic policies and manages industrial relations. Tensions will get worse before they get better. Austria's stimulus is sizable (over 3% of GDP) -- as are automatic stabilizers -- but the GoA needs to accelerate discretionary spending. Coalition watchers say the biggest political challenge is not the current period of "crisis management" -- rather, the moment of truth will come (at the latest) in 2010, when stimulus funds evaporate and Austria's leadership must consolidate budgets without unraveling the country's basic consensus (at a time when its labor market will probably still be worsening).
END COMMENT.

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